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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CORDIS CORPORATION,

Petitioner,

vs.

MEDTRONIC, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. Is the public interest served by allowing the Federal Circuit to subvert federal patent policies in favor of contract principles, contrary to this Court's mandate in its landmark decision in *Lear v. Adkins* and, more specifically, by precluding a patent licensee from escrowing royalties during his challenge of an invalid patent?

2. Are the interests of the U.S. patent system served by the Federal Circuit when it denies a patent licensee the right to escrow royalties during his challenge of an invalid patent, contrary to the decision of this Court (and the Sixth and Seventh Circuits) which held that a licensee should *not* be compelled to pay royalties while challenging the validity of the licensed patent?

PARTIES TO THE PROCEEDING

The parties to the proceeding below are CORDIS CORPORATION, plaintiff in the District Court and appellee in the Court of Appeals, and MEDTRONIC, INC., defendant in the District Court and appellant in the Court of Appeals.[1]

[1] Pursuant to Rule 28.1 CORDIS CORPORATION has no parent company or wholly owned subsidiary. It is affiliated with Cordis-Dow, of Midland, Michigan.

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CORDIS CORPORATION,

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vs.

MEDTRONIC, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

CORDIS CORPORATION (hereinafter CORDIS), hereby petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit. This Petition is occasioned by the Court of Appeals' failure to apply the federal patent policy mandate of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

OPINIONS BELOW

The Court of Appeals' Opinion of December 17, 1985, vacating the District Court's Order, is reported at 780 F.2d 991, and is included at pages 1a-8a in the Appendix to this Petition. CORDIS' Petition For Rehearing was denied, without opinion, on February 14, 1986 (9a).

The District Court's Order of January 9, 1985, granting CORDIS' Motion For Establishment of Escrow Fund and For Preliminary Injunction, is reported at 606 F. Supp. 132 and is included in the Appendix at pages 10a-12a.

GROUNDS OF JURISDICTION

The opinion of the Court of Appeals for the Federal Circuit was entered on December 17, 1985, and a timely-filed Petition For Rehearing was denied on February 14, 1986.

This Court has jurisdiction under 28 U.S.C. 1254(1).

CONSTITUTIONAL PROVISIONS INVOLVED

CONSTITUTION:

Art. 1, Sec. 8, Cl. 8

> The Congress shall have power... To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.

Art. VI, Cl. 2

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby; any Thing in the Constitution or Laws of any State to the Contrary nothwithstanding.

STATEMENT OF THE CASE

1. The Factual Background And The Decision Below

CORDIS is non-exclusively licensed by MEDTRONIC, INC. (hereinafter "MEDTRONIC"), under two United States patents (i.e., the licensed patents in suit). In September, 1984 CORDIS became aware of important "new evidence" pertaining to the validity of the licensed patents. As acknowledged by the Court of Appeals, this evidence was arguably sufficient to establish the invalidity of the licensed patents (8a).

In October, 1984, CORDIS requested that MEDTRONIC agree to a voluntary escrow of royalties accruing under the License Agreement until the new evidence was heard and evaluated in a case then pending in the District of Minnesota. MEDTRONIC refused.

Accordingly, on October 19, 1984, CORDIS filed a Complaint for Declaratory Judgment of invalidity of the licensed patents in suit,[2] and simultaneously moved: (1) to establish an interest bearing escrow account for the receipt of royalty payments due and owing to MEDTRONIC under the terms of the License Agreement during the pendency of this Declaratory Judgment action, the funds accumulated in the escrow account to be disbursed to the prevailing party in this action; and (2) to enjoin MEDTRONIC from terminating the License Agreement during the pendency of this Declaratory Judgment action.

The Motion was fully briefed by both parties, and oral argument was held. On January 9, 1985 the District Court granted CORDIS' Motion and established the proposed escrow and injunction. The District Court concluded that:

> [t]he circuits are split on the issue of whether to establish escrow accounts for the collection of royalty payments during the pendency of patent infringement suits. I have

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[2] The District Court has original and exclusive jurisdiction of this cause of action under 28 U.S.C. 1338.

decided, however, that *Precision Shooting Equipment Co. v. Allen*, 646 F.2d 313 (7th Cir. 1981) and *Atlas Chemical Industries, Inc. v. Moraine Products*, 509 F.2d 1 (6th Cir. 1974) are more faithful to the spirit of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), where the Supreme Court held that licensee estoppel is no longer valid law."[3]

MEDTRONIC appealed the entry of that Order.

2. The Federal Circuit's Decision

On December 17, 1985, the Court of Appeals for the Federal Circuit vacated the District Court's Order and remanded this case to the District Court for further consideration. The Court concluded that the District Court made several errors of law relating to the interpretation and application of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

According to the Court of Appeals, the District Court misapplied *Lear* in evaluating the rights and obligations of the parties and the interest of the public (6a). In particular, the Federal Circuit decided that the District Court erred "in ruling that the *Lear* decision is implicit authority for permitting a licensee to deposit royalties due *pendente lite* into an escrow account pending a determination on the merits" (4a). The Court of Appeals could "find no authority in *Lear* for establishing an escrow for royalties due *pendente lite* or preliminarily enjoining a licensor from cancelling the license agreement" (5a), and held that *Lear* only precluded "the affirmative enforcement by the licensor of the royalty payment provision of the license agreement while the patent's validity is being challenged by the licensee" (6a).

The Court of Appeals also found that the District Court erred, with respect to the requirement of irreparable harm, in

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[3] The contrary circuit court decisions are *Warner-Jenkinson Co. v. Allied Chemical Corp.*, 567 F.2d 184, 193 USPQ 753 (2d Cir. 1977); and *Nebraska Engineering Corp. v. Shivvers*, 557 F.2d 1257, 195 USPQ 227 (8th Cir. 1977).

"reading that the Sixth Circuit *Troxel* (I)[4] opinion is authority for the proposition that a licensee may never recoup royalties" (4a-5a). Although holding that the District Court's reliance on Troxel (I) was faulty, the Court of Appeals *specifically declined* to decide whether a licensee who is successful in its validity challenge is entitled to the return of royalties paid *pendente lite* (8a).

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS' DECISION IS CONTRARY, IN RATIONALE AND EFFECT, TO THE SUPREME COURT'S MANDATE IN *LEAR*

Lear v. Adkins, 395 U.S. 653 (1969), is a watershed decision in patent law. Reversing over a century of case law, *Lear* abolished the doctrine of licensee estoppel (which precluded a patent licensee from challenging the validity of the licensed patent) and held that a licensee may not be compelled to pay royalties while challenging the validity of the licensed patents. Indeed, *Lear* established, once and for all, the preeminence of federal patent policy over contract doctrine.

In abolishing licensee estoppel, the Court stated:

> Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. *Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would be monopolists without need or justification.* (Emphasis added)

395 U.S. at 670.

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[4] *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 465 F.2d 1253, 175 USPQ 65 (6th Cir. 1972).

Similar reasoning also supported the holding that a licensee may not be required to pay royalties while challenging patent validity:

> The parties' contract, however, is no more controlling on this issue than is the State's doctrine of estoppel, which is rooted in contract principles. *The decisive question is whether overriding federal policies would be significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging validity in the courts.*
>
> *It seems to us that such a requirement would be inconsistent with the aims of federal patent policy.* Enforcing this contractual provision would give the licensor an additional economic incentive to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning. We can perceive no reason to encourage dilatory court tactics in this way. Moreover, the cost of prosecuting slow-moving trial proceedings and defending an inevitable appeal might well deter many licensees from attempting to prove patent invalidity in the Courts. (Emphasis added)

395 U.S. at 673.

This language is plain and unequivocal. It sets forth a public policy mandate based on the pre-eminence of federal patent policy over private contract doctrine, which is not and should not be limited to the particular facts in *Lear*. The Supreme Court repeatedly emphasized in *Lear* that to implement this mandate: (1) the licensee, who may be the only person with sufficient interest to challenge patents believed to be invalid, must be unmuzzled; (2) obstacles which may chill or frustrate a licensee's willingness to undertake a validity challenge or which may give rise to dilatory tactics or delay by the licensor must be removed; and (3) prompt and vigorous resolution of patent validity issues must be encouraged.

If not reversed, the Federal Circuit's refusal to allow post-challenge royalties to be deposited into an escrow account, without threat of license termination, will undo the very thing *Lear* sought to accomplish. In stark contrast to the public

policy objectives of *Lear*, the Federal Circuit's decision places substantial obstacles in the path of a patent licensee who seeks to challenge patent validity; creates real incentives for delay and for dilatory court tactics; and, in the end, muzzles the licensee as effectively as if the *Lear* decision never existed. The Federal Circuit decision would allow patent licensors to avoid the consequences of *Lear* by the simple expedient of terminating the license if the licensee refuses to pay royalties to the licensor during the validity challenge. In such event, the licensee would, of course, be exposed to the threat of an injunction, treble damages and other relief — a result which *Lear* specifically sought to avoid.

As *Lear* is interpreted by the Federal Circuit, a patent licensee who believes the licensed patent(s) to be invalid (even if based on information discovered after entering the license) has only two courses of action: (1) continue to pay royalties to the licensor (thereby funding the licensor's war chest) while litigating validity, without any assurance of the return of the royalties if successful, or (2) cease paying royalties, thereby automatically exposing itself to license termination, and potential injunction, treble damages and other relief.

This is truly a "Hobson's choice" which frustrates the overriding federal policies of *Lear* just as surely as actually ordering that royalties be paid during the litigation. In the first alternative, the licensee must pay the royalties accruing *pendente lite* without any assurance of their return. Although the Federal Circuit decision held that *Troxel* (I) did not preclude return of royalties paid *pendente lite*, the *Court expressly refused to decide whether such royalties should be returned.* Thus, the issue of entitlement to royalties paid *pendente lite*, remains in substantial doubt, steeped with uncertainty. Certainly, based on this authority, counsel could not advise a client that post-challenge royalties would definitely be refunded if the challenge is successful.

The practical result is, of course, that it is highly unlikely that a licensee would be willing to undertake the time, expense,

and other risks associated with a patent validity challenge, if the licensee were required to continue paying royalties that *may* not be refundable. Should a licensee choose to proceed with such litigation, and is found not to be entitled to recover post-challenge royalties, the licensor will have achieved indirectly that which *Lear* directly prohibited — i.e., requiring the payment of royalties during a validity challenge (395 U.S. at 673).

The second alternative offers the same unacceptable risks to a licensee. By refusing to pay royalties during litigation, the licensee is exposed to likely termination of the license and thus to an injunction, increased damages, and other relief. CORDIS respectfully submits that most reasonable and well-advised licensees would not pursue this undesirable choice.

Accordingly, the practical effect of the Federal Circuit's decision is the very result which the Supreme Court sought to avoid in *Lear*. Licensed patents believed to be invalid simply will not be litigated, and the licensor will continue to profit to the detriment of the licensee and to the public.

II. THE OVERRIDING PUBLIC POLICY ARTICULATED IN *LEAR* AND THE INTERESTS OF BOTH PARTIES AND THE PUBLIC ARE BEST SERVED BY ESCROWING ROYALTIES ACCRUING *PENDENTE LITE*

The interesting-bearing escrow established by the District Court is an even-handed and responsible way of implementing the public policy considerations of *Lear* and maintaining the status quo — without unduly interfering with the contractual arrangements between the parties. More particularly, the escrow permitted by the District Court protects *both* CORDIS (the licensee) and MEDTRONIC (the licensor) during the pendency of this Declaratory Judgment action, without unfairly benefitting either.

CORDIS must continue to make the required royalty payments into the escrow. If CORDIS is unsuccessful in its challenge, MEDTRONIC is assured of promptly receiving the escrowed royalties. On the other hand, if CORDIS is successful in its challenge, the escrowed royalties will be promptly refunded. Neither party is given an unfair advantage over the other, and the only detriment whatsoever to MEDTRONIC is the delay in receiving the escrowed royalties. The delay, however, is clearly compensable through the interest earned by the escrow.

Such an escrow arrangement clearly eliminates the "chilling effect" imposed on the challenger-licensee because of the uncertainty about repayment of royalties. As noted earlier, that uncertainty arises, in part, because of the Sixth Circuit's decision in *Troxel* (I) precluding the return of paid royalties. More importantly, this Court and a majority of the Circuit Courts, have *not* decided whether a licensee who is successful in establishing invalidity of the licensed patent is entitled to a refund of paid or escrowed royalties, or whether such royalties are irretrievably lost. Although the Appellate Court held that *Troxel* (I) did not preclude return of royalties, *it expressly refused to decide whether a licensee was entitled to a refund of royalties paid pendente lite.* Under the Federal Circuit decision, the "chilling effect" remains.

The escrow also achieves the objectives of *Lear* by providing an incentive for prompt and vigorous prosecution of the invalidity challenge and a disincentive for delay and dilatory tactics by either party. CORDIS must still make the required royalty payments into the escrow and, accordingly, it is to CORDIS' benefit to prosecute its Declaratory Judgment action vigorously so as to obtain an early refund of the escrowed royalties. On the other hand, because the royalties are not being paid to MEDTRONIC, MEDTRONIC has the same incentive to aggressively pursue a prompt resolution of the issues in order to obtain the escrowed royalties. In contrast, if

the royalties were paid directly to MEDTRONIC, there would be a substantial economic incentive, just as there would have been for the patentee in *Lear*, "to devise every conceivable dilatory tactic in an effort to postpone the day of final judicial reckoning," 395 U.S. at 673.

III. *LEAR* HAS BEEN SUBJECT TO CONFLICTING INTERPRETATION

It is clear that this Court in *Lear* set forth a public policy mandate which reaches far beyond the particular issues and facts in *Lear*. In the seventeen years since *Lear*, however, the lower courts have been without Supreme Court guidance as to the proper scope and interpretation of *Lear*. This has resulted in dramatically inconsistent decisions concerning the application of *Lear* to issues and factual situations not specifically addressed in *Lear*.

It is undisputed, for example, that *Lear* did not specifically address the use of an escrow for post-challenge royalties or the issue of entitlement to post-challenge royalties. However, the actual holding in *Lear* and its public policy mandate plainly have implications that bear directly on these questions, which are raised in the present case. Nonetheless, these issues have been answered, as the District Court acknowledged, in different and conflicting ways by the various Circuit and District Courts.

1. The Sixth And Seventh Circuits Have Endorsed The Escrowing Of Royalties

In *Atlas Chemical Industries, Inc. v. Moraine Products*, 509 F.2d 1 (6th Cir. 1974) and *Precision Shooting Equip. Co. v. Allen*, 646 F.2d 313 (7th Cir. 1981),[5] the Sixth and Seventh Circuit Courts of Appeal endorsed the use of an escrow as the fairest way of managing royalties accruing *pendente lite*, in

[5] A similar analysis and conclusion was reached in *Lee v. Lee Custom Engineering, Inc.*, 476 F.Supp. 361 (E.D. Wis. 1979).

accordance with the principles set forth in *Lear*, as it gives neither party undue burden or benefit.

In *Atlas Chemical*, the Sixth Circuit was reviewing a judgment holding the licensed patent invalid and directing that royalties which had been escrowed *pendente lite* be paid over to the licensor. 509 F.2d at 2. The Court of Appeals affirmed the finding of invalidity, but reversed as to the escrowed royalties. The Sixth Circuit reasoned that payment of the escrowed royalties to the licensor was inconsistent with one of the primary goals of *Lear* — to "unmuzzle" licensees so that an early adjudication of invalidity could be achieved to the real benefit of the public.

According to the Sixth Circuit in *Atlas Chemical*, the existence of an escrow would not change the results insofar as entitlement to post-challenge royalties is concerned, but an escrow would fairly preserve the *status quo:*

> The payment of royalties in escrow does not change the result in this case. *While an escrow is a commendable procedure to preserve the status quo during the course of litigation*, the funds belong to neither party until the validity of the patent is determined. (Emphasis added) 509 F.2d at 7.

The Seventh Circuit Court of Appeals also endorsed the use of an escrow for post-challenge royalties in *Precision Shooting Equipment Co. v. Allen*, 646 F.2d 313 (7th Cir. 1981). That case, like the present case, was an appeal from an interlocutory order establishing an escrow and preliminarily enjoining the patentee from terminating the license.

After a detailed analysis of *Lear*, the Seventh Circuit held that a patent licensee is entitled to a refund of escrowed royalties paid during its patent validity challenge, and particularly approved the use of an escrow to implement that approach—

> [A]ll the post-challenge royalties are safely in escrow for whomever may be found to be entitled to them. It appears

> delay in resolution of the controversy favors neither party. Nor is either party made to assume risks not necessary to the resolution of validity. We adopt that approach. *Id.* at 321.

In summary, the Sixth and Seventh Circuits have both adopted the so-called "challenge approach," which entitles the licensee to a return of any escrowed royalties paid after it has initiated a patent validity challenge — and endorsed the use of an escrow for post-challenge royalties as the most efficient, effective, and fair procedure for achieving the overriding policy considerations of *Lear*.

2. The Second And Eighth Circuits Have, Contrary To The Rationale Of *Lear*, Refused To Allow Escrowing Of Royalties

In *Warner-Jenkinson Co. v. Allied Chemical Corp.*, 567 F.2d 184 (2d Cir. 1977), the licensee brought a suit for declaratory judgment of patent invalidity and sought an order allowing it to deposit royalty payments into escrow *pendente lite*. The District Court dismissed the Complaint because of the existence of the license.

The Second Circuit reversed the dismissal of the complaint and rejected the escrow approach on the ground that it would put undeserved pressure on the licensor. Providing payment directly to the licensor during the challenge, with the possibility of royalty repayment, was in the Second Circuit's opinion most consistent with the statutory presumption of patent validity.[6]

The Eighth Circuit also has refused to allow the use of an escrow for a licensee's post-challenge royalties, *Nebraska Engineering Corp. v. Shivvers*, 557 F.2d 1257 (8th Cir. 1977). That case also involved a declaratory judgment action by a licensee seeking to invalidate the licensed patent. Simultaneously with

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[6] In this case, CORDIS presented evidence which, as acknowledged by the Federal Circuit, arguably rendered the licensed patents invalid.

the complaint, the licensee filed a motion for an order authorizing the licensee to pay royalties to an escrow agent and enjoining the licensor from terminating the license agreement.

The District Court granted the licensee's motion, but the Eighth Circuit reversed, applying a very limited interpretation of *Lear*, and deferring to the Second Circuit decision in *Warner-Jenkinson*.[7] The Eighth Circuit was of the opinion that *Lear* merely prevented *affirmative* enforcement of royalty payment provisions during a licensee's validity challenge. Whether the Court's ruling served or disserved the policy ends of *Lear* was not apparently raised (it was certainly not addressed) in the appeal.

CONCLUSION

The Federal Circuit's decision in this case is contrary, in rationale and effect, to the Supreme Court's mandate in *Lear*. The Federal Circuit's decision that *Lear* should be strictly interpreted will largely undo what *Lear* sought to achieve. It will, on the one hand, create substantial disincentives for licensees to challenge validity; and, on the other hand, create incentives for dilatory trial practices.

There has been no Supreme Court guidance since *Lear* and this has resulted in strikingly different interpretations and applications of *Lear* by the Federal Circuit and District Circuits, particularly with respect to the issues raised in this Petition.

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[7] The Eighth Circuit specifically declined, as did the Federal Circuit in this case, to rule on which party is entitled to royalties paid during the validity challenge.

For the reasons set forth above, it is respectfully requested that this Petition for a Writ of Certiorari be granted.

Respectfully submitted,

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Certificate Of Service

It is hereby certified that at least three copies of the foregoing PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT have been mailed first-class postage prepaid, to:

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Mary W. McGowan

APPENDIX

United States Court of Appeals
for the Federal Circuit

CORDIS CORPORATION,

Appellee,

v. Appeal No. 85-1987

MEDTRONIC, INC.,

Appellant.

DECIDED: December 17, 1985

Before KASHIWA, *Circuit Judge*, SKELTON, *Senior Circuit Judge*, and BISSELL, *Circuit Judge*.

BISSELL, *Circuit Judge*.

This appeal is from the Order of the District Court for the Southern District of Florida, No. 84-2479-CIV-Atkins, (January 10, 1985), granting the motion for relief *pendente lite* of Cordis Corporation (Cordis):

(a) permitting Cordis to deposit into an escrow account all future royalty payments due Medtronic, Inc. (Medtronic) pursuant to the license agreement between the parties; and

(b) enjoining Medtronic from terminating the license agreement because of Cordis' failure to make royalty payments pursuant to the agreement. This in effect protects Cordis from patent infringement or breach of contract counterclaims.

The issuance of the Order by the district court is vacated. The motion for relief *pendente lite* is remanded for further consideration not inconsistent with this opinion.

I

Cordis filed suit against Medtronic seeking a declaratory judgment that the two licensed Medtronic patents, U.S. Patent Nos. 3,902,501 ('501) and 3,939,843 ('843), are invalid (Count I of the Complaint) and that the license agreement between Cordis and Medtronic "is void in its inception" (Count II of the Complaint). Contemporaneous with filing of the declaratory judgment action, Cordis moved for an order to establish a court escrow account into which the royalty payments due Medtronic, *pendente lite*, would be deposited. Additionally, Cordis sought a preliminary injunction to enjoin Medtronic from terminating the license agreement during the pendency of the patent invalidity suit.

The district court, relying on *Precision Shooting Equipment Co. v. Allen*, 646 F.2d 313, 210 USPQ 184 (7th Cir.), *cert. denied*, 454 U.S. 964 (1981), and *Atlas Chemical Industries, Inc. v. Moraine Products*, 509 F.2d 1, 184 USPQ 281 (6th Cir. 1974), granted the motion and permitted Cordis to deposit any royalty payments due Medtronic *pendente lite* into an interest bearing escrow account, with all funds accumulated in the escrow account to be paid to the prevailing party. The district court enjoined Medtronic from terminating the license agreement during the pendency of the action.

Consequently, the issue on appeal to this court is whether the district court properly granted the preliminary injunction and Cordis' motion for establishment of the escrow account.

II

Our jurisdiction over this appeal arises under 28 U.S.C. § 1292(a)(1) and (c) which permits interlocutory appeals from trial court orders granting injunctions. Because a portion of the district court's interlocutory order enjoins Medtronic from terminating the license agreement, we have jurisdiction

over the whole order, including the portion establishing a court escrow account for depositing royalty payments. *Jaffee v. United States*, 592 F.2d 712 (3d Cir. 1979), *on remand*, 468 F. Supp. 632 (D.N.J. 1979), *cert. denied*, 441 U.S. 961 (1979), *aff'd*, 663 F.2d 1226 (3rd Cir. 1981), *cert. denied*, 456 U.S. 972 (1982); *see also United States v. Connolly*, 716 F.2d 882, 885 (Fed. Cir. 1983) (Under 28 U.S.C. § 1292(d)(2), this court's scope of review is not limited to the certified question. We can consider all questions material to the correctness of the interlocutory order.)

III

The Supreme Court, in *Lear, Inc. v. Adkins*, 395 U.S. 653, 671, 162 USPQ 1, 8 (1969), held that a licensee to a patent license agreement is not estopped from contesting the validity of the patent subject to the agreement. *Lear* further held that licensees cannot be required to continue to pay royalties during the time they are challenging patent validity in the courts. *Id.* at 673, 162 USPQ at 9. In *C. R. Bard, Inc. v. Schwartz*, 716 F.2d 874, 219 USPQ 197 (Fed. Cir. 1983), this court held that a patent licensee may seek a federal declaratory judgment to declare a patent, subject to a license, invalid without prior termination of the license.

It is well settled that the purpose of an interlocutory injunction is to preserve the status quo and to protect the respective rights of the parties pending a determination on the merits. *Atlas Powder Co. v. Ireco Chemicals*, 773 F.2d 1230, 227 USPQ 289 (Fed. Cir. 1985); *Smith International, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 219 USPQ 686 (Fed. Cir.), *cert. denied*, 464 U.S. 996, 220 USPQ 385 (1983); *accord Cate v. Oldham*, 707 F.2d 1176 (11th Cir. 1983). The status of these parties before the district court is that of a patentee-licensor of two patents, each presumptively valid pursuant to 35 U.S.C. § 282, and that of a licensee of those patents.

This court exercises a very narrow scope of review over the district court's grant of injunctive relief. *Smith International,* 718 F.2d at 1579, 219 USPQ at 691. The district court's determination can be overturned only upon a showing that it abused its discretion, committed an error of law, or seriously misjudged the evidence. *Rogers v. Hill,* 289 U.S. 582, 587 (1933); *National File Ins. Co. v. Thompson,* 281 U.S. 331, 338 (1930); *Meccano, Ltd. v. John Wanamaker,* 253 U.S. 136, 141 (1920); *Smith International,* 718 F.2d at 1579, 219 USPQ at 691.

In determining whether to grant or deny the requested injunction, a court must exercise sound discretion and examine the appropriate factors in granting the motion. The factors to be considered in granting a preliminary injunction in the Federal Circuit are the same as those of the Eleventh Circuit. The district court must examine and balance the parties' asserted rights, the acts sought to be enjoined, the likelihood that the movant will prevail on the merits, the irreparable nature of the harm if the injunction is not granted, and whether the public interest is better served by issuing rather than denying the injunction. *Smith International,* 718 F.2d at 1579, 219 USPQ at 690-91; *S J. Stile Associates, Ltd. v. Snyder,* 646 F.2d 522, 525 (CCPA 1981); *accord Cate v. Oldham,* 707 F.2d 1176 (11th Cir. 1983); *Harris Corp. v. National Iranian Radio and Television,* 691 F.2d 1344 (11th Cir. 1982); *see generally Atlas Powder Co.,* 773 F.2d at 1232-34, 227 USPQ 291-93; *Roper Corp. v. Litton Systems, Inc.,* 757 F.2d 1266, 225 USPQ 345 (Fed. Cir. 1985).

We find that several errors of law and a misjudgment of evidence occurred when the district court considered the preliminary injuction factors. Initially, the district court erred in ruling that the *Lear* decision is implicit authority for permitting a licensee to deposit royalties due *pendente lite* into an escrow account pending a determination on the merits. A second error of law appears in the district court's reading that the Sixth

Circuit *Troxel (I)*[1] opinion is authority for the proposition that a licensee may never recoup royalties. Finally, it was a misjudgment of evidence to use evidence to patent invalidity to establish the movant's likelihood of success on the claim that the license "is void in its inception."

Turning to the error committed in reading the *Lear* opinion, we find no authority in *Lear* for establishing an escrow account for royalties due *pendente lite* or preliminarily enjoining a licensor from cancelling the license agreement and, thus, from counterclaiming for patent infringement when this material breach of the license occurs.

Cordis argued and the district court agreed that the Supreme Court decision in *Lear* encouraging vigorous and prompt litigation of invalid patents supports the entry of the requested interlocutory relief. In *Lear*, the Court examined the interests of the licensor, the licensee, and the general public in light of the federal patent policy encouraging prompt adjudication of patent validity, stating:

> Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. We think it plain that the technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued.

Lear, 395 U.S. at 670-71, 162 USPQ at 8.

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[1] *Troxel Manufacturing Co. v. Schwinn Bicycle Co.*, 465 F.2d 1253, 175 USPQ 65 (6th Cir. 1972) (*Troxel I*).

This public policy statement *does* permit a licensee to cease payments due under a contract while challenging the validity of a patent. . It *does not* permit the licensees to avoid facing the consequences that such an action would bring. The holding of *Lear* only prevents the affirmative enforcement by the licensor of the royalty payment provisions of the license agreement while the patent's validity is being challenged by the licensee.

We believe that the reasoning succinctly stated by the Second Circuit in *Warner-Jenkinson Co. v. Allied Chemical Corp.*, 567 F.2d 184, 193 USPQ 753 (2d Cir. 1977) and followed by the Eighth Circuit in *Nebraska Engineering Corp. v. Shivvers*, 557 F.2d 1257, 195 USPQ 227 (8th Cir. 1977) is in keeping with the holding of and policy statements in *Lear:*

> We believe that if the plaintiffs wish to continue to invoke the protections of their licensing agreements, they should be required to continue paying their royalties to the defendant. Ultimately, all royalties paid after the filing of the complaint *may* have to be returned to the plaintiffs. . . . At present, plaintiffs already have the option of withholding royalties and thereby breaching the licensing agreement; of course, they would then run the risk of an injunction if they should lose on the merits. It would not be fair for the plaintiffs to be allowed simultaneously to reap all the benefits of the licensing agreement and to deprive the licensor of all his royalties. Patents are presumed to be valid, 35 U.S.C. § 282; until invalidity is proven, the patentee should ordinarily be permitted to enjoy the fruits of his invention. The principal effect of an escrow arrangement would be to put undeserved pressure on the defendant.

Warner-Jenkinson, 567 F.2d at 188, 193 USPQ at 753 (emphasis added).

In addition to the misapplication of *Lear* in evaluating the rights and obligations of the parties and the interest of the public, the district court made errors of law in determining whether irreparable harm would occur to the licensee if the preliminary injunction was not granted.

To support its request for injunctive relief, Cordis argued that absent such relief it would experience irreparable harm in one of the following four ways: (1) being exposed to a potential patent infringement suit, (2) risking forfeiture of royalties paid while litigating the validity of the patents,[2], (3) foregoing contesting the validity of the patents, or (4) terminating any manufacture, use or sale of the tined leads covered by the '501 and '843 patents.

Cordis argued to the district court that any one of these alternatives, when balanced against the harm suffered by Medtronic in receiving delayed royalty payments, tips the scales of equity in favor of permitting royalties due *pendente lite* to be deposited into an interest bearing escrow account.

With regard to Cordis' first, third, and fourth assertions of irreparable harm, for the reasons stated above, *Lear* provides no reprieve. Moreover, Cordis made no showing that Medtronic is financially irresponsible or might be judgment-proof at the end of the litigation. "Only a viable threat of serious harm which cannot be undone authorizes exercise of a court's equitable power to enjoin before the merits are fully determined. (Citation omitted). A preliminary injunction will not issue simply to prevent a mere possibility of injury, even where prospective injury is great." *S. J. Stile*, 646 F.2d at 525; *See Smith International*, 718 F.2d at 1579, 219 USPQ at 692.

With regard to Cordis' second assertion of irreparable harm, the district court's reliance on *Troxel (I)* is misplaced. Neither the *Troxel (I)* nor *Troxel (II)* decisions by the Sixth Circuit prohibit the licensee from recouping royalties paid *pendente lite* once the patent subject to the license agreement is proved invalid. The *Troxel* decisions only prohibit the licensee from recovering and retaining royalties paid or due prior to the

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[2] Cordis cites the *Troxel I* decision and the subsequent *Troxel Manufacturing Co. v. Schwinn Bicycle Co.*, 489 F.2d 968, 180 USPQ 290 (6th Cir. 1973), *cert. denied*, 416 U.S. 939, 181 USPQ 417 (1974)(Troxel II), decision as authority for this position.

adjudication of invalidity when the challenge to the patent was made by a third party. Since the district court improperly evaluated the rights of the parties and the interest of the general public under *Lear*, we need not address the risk of forfeiture question any further than the district court's application of *Troxel (I)*. Nor do we decide which party is entitled to royalties paid or accrued *pendente lite*.

Finally, the district court erred in evaluating the likelihood of success factor. To show likelihood of success on the merits, Cordis offered only the affidavit of an engineer employed by Medtronic's competitor, Pacesetter, which set forth that Pacesetter publicly disclosed and/or developed certain devices covered by claims of the patents in suit prior to Medtronic's alleged date of invention. The district court's error occurred in using evidence of patent invalidity to establish the movant's likelihood of success on the claim that the license "is void in its inception" (Count II). The affidavit by an employee of Medtronic's competitor setting forth facts is arguably sufficient to prove that the patents in suit are invalid under the provisions of 35 U.S.C. § 102(a) and (b). However, this affidavit alone is insufficient to support the movant's likelihood of success on the second count of the complaint, that is, that the license agreement "is void in its inception." Patents are issued by the government after examination and evaluation of the patent application by the United States Patent and Trademark Office and are presumed valid once issued. 28 U.S.C. § 282. As observed by the Sixth Circuit, "Congress has not seen fit to create an implied warranty of validity in license agreements." *Troxel (I)*, 465 F.2d at 1260, 175 USPQ at 70. "Absent fraud or misconduct, a patentee should not be held responsible for the issuance of an invalid patent." *Id.* at 1259, 175 USPQ at 69.

Consequently, because the analysis underlying the district court's order is erroneous, the order is vacated and the motion remanded for further consideration not inconsistent with this opinion.

VACATED AND REMANDED

United States Court of Appeals
for the Federal Circuit

CORDIS CORPORATION,
Appellee,

v.

MEDTRONIC, INC.,
Appellant.

No. 85-1987

ORDER

A petition for rehearing and a suggestion for rehearing in banc having been filed in this case,

UPON CONSIDERATION THEREOF, it is Ordered by the court that the petition for rehearing be, and the same is hereby, Denied.

The suggestion for rehearing in banc is declined.

FOR THE COURT

/s/ FRANCIS X. GINDHART
Francis X. Gindhart, Clerk

Date: February 14, 1986

cc: Lawrence C. Brown
Granger Cook, Jr.

United States District Court
Southern District of Florida

Cordis Corporation,

Plaintiff,

v.

No. 84-2479-
CIV-Atkins

Medtronic, Inc.,

Defendant.

Order GRANTING Cordis' Motion For Establishment Of Escrow Fund And For Preliminary Injunction

This cause is before the court on plaintiff, Cordis Corporation's Motion For Establishment Of Escrow Fund And For Preliminary Injunction. Based upon careful consideration of the record and oral arguments in this case, it is hereby

ORDERED AND ADJUDGED that the Motion is GRANTED.

Until final judgment is rendered in this action, Cordis will be permitted to deposit any royalty payments due and owing to Medtronic, Inc. into an interest-bearing escrow account, provided that upon final judgment, all funds accumulated in the escrow account are to be paid over to the prevailing party, and Medtronic, Inc. is enjoined from terminating the License Agreement during the pendency of this action.

The court notes that the circuits are split on the issue of whether to establish escrow accounts for the collection of royalty payments during the pendency of patent infringement suits. I have decided, however, that *Precision Shooting Equipment Co. v. Allen*, 646 F.2d 313 (7th Cir. 1981) and *Atlas Chemical Industries, Inc. v. Moraine Products*, 509 F.2d 1 (6th Cir. 1974) are more faithful to the spirit of *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), where the Supreme Court held that licensee estoppel is no longer valid law.

Under well-established case law, the party requesting a preliminary injunction bears the burden of establishing to the District Court that: 1) It has a substantial likelihood of eventual success on the merits; 2) Irreparable injury will be suffered unless the injunction issues; 3) The threatened injury to the movant outweighs the damage which the injunction may cause the opponent; and 4) The injunction would not be adverse to the public interest. *Productos Carnic, S.A. v. Central American Beef and Seafood Trading Co.*, 621 F.2d 683, 685 (5th Cir. 1980); *Dallas Cowboy Cheerleaders, Inc. v. Scoreboard Posters, Inc.*, 600 F.2d 1184, 1187 (5th Cir. 1979); *Texas v. Seatrain International, S.A.*, 518 F.2d 175, 179 (5th Cir. 1975). The Affidavit of Harry W. Fletcher sets forth the fact that PACESETTER publicly disclosed and/or developed certain devices covered by the claims of U.S. Patent No. 3,902,501 prior to the alleged invention defined by the claims of such patent. If this allegation is proven true, than the patents-in-suit would arguably be invalid under the provisions of 35 U.S.C. 102(a) and (b). Second, if Cordis fails to make its royalty payments to Medtronic, it will be vulnerable to a patent infringement action, with the prospect of paying treble damages and of being enjoined from manufacture and sale of the licensed products. If Cordis continues to make royalty payments while seeking to invalidate the patents in suit in this action, the royalty payments made to Medtronic cannot be recovered under *Troxel Manufacturing Co. v. Schwinn Bicycle*, 465 F.2d 1253 (6th Cir. 1972). Once the royalty payments are made, there is no legal remedy available for repayment. If there is no legal redress, Cordis would be irreparable damaged. This damage far outweighs any damage Medtronic would suffer by the issuance of an injunction preventing the termination of the license agreement and the establishment of an escrow account for payment of royalties. Finally, the public has a clearly established interest in having invalid patents challenged in Federal courts. Should Cordis be successful, the claimed subject matter of the patents at suit would enter the

public domain and Medtronic would no longer be entitled to maintain a legal monopoly in the claimed subject matter. The public interest would clearly be served by providing Cordis with reasonable protection so that it may challenge two patents which it believes invalid.

Done and Ordered at Miami, Florida this 10 day of January, 1985.

/s/ CLYDE ATKINS
CLYDE ATKINS
United States District Judge

CC: Lowell L. Garrett
Granger Cook, Jr.
George H. Gerstman
Henry W. Collins
Hal Vogel

Supreme Court, U.S.
FILED
APR 29 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1443 (2)

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1985

CORDIS CORPORATION,
Petitioner,
vs.
MEDTRONIC, INC.,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION

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43 pp

RESTATEMENT OF QUESTIONS PRESENTED

1. Did the Federal Circuit's decision to vacate the District Court's Order (i) granting interlocutory relief permitting Petitioner to deposit into escrow future royalty payments due Respondent under the License Agreement between the parties, and (ii) enjoining Respondent from terminating the License Agreement, produce a result in conflict with this Court's decision in Lear, Inc. v. Adkins?
2. Was the Federal Circuit's decision to reverse the District Court's grant of relief pendente lite on grounds that the District Court had misjudged the evidence and committed errors of law in its application of the traditional standard for injunctive relief erroneous?

PARTIES TO THE PROCEEDING

See Petition at page ii.[1]

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1. Pursuant to Supreme Court Rule 28.1, Medtronic, Inc. has no parent company or subsidiaries, except wholly owned subsidiaries. It holds small minority interests in Bio-Medicus, Inc., located in Minnetonka, Minnesota; Bio-Nexus located in Raleigh, North Carolina; Xenotech, located in Irvine, California; Life Science Instrumentation, Inc., located in Portland, Oregon; and City Venture Corporation, located in Minneapolis, Minnesota. Although Medtronic, Inc. does not regard these corporations as "affiliates," they are identified here in the interest of full and complete disclosure.

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1985

CORDIS CORPORATION,
Petitioner,
vs.
MEDTRONIC, INC.,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Order dated January 10, 1985, of the United States District Court, Southern District of Florida, granting Petitioner's Motion for Establishment of Escrow Fund and for Preliminary Injunction is reported at 606 F. Supp. 132,

and is reproduced in Petitioner's Appendix at pages 10a-12a.

The panel decision of the United States Court of Appeals for the Federal Circuit dated December 17, 1985, vacating the District Court's Order is reported at 780 F.2d 991, and is reproduced in Petitioner's Appendix at pages 1a-8a. Petitioner's Petition for Rehearing and Suggestion for Rehearing In Banc was denied by Order dated February 14, 1986, a copy of which is reproduced in Petitioner's Appendix at page 9a.

JURISDICTION

See Petition at page 2 for jurisdictional ground asserted.

CONSTITUTIONAL PROVISIONS INVOLVED

See Petition at page 2.

STATEMENT OF THE CASE

1. Factual Background and the District Court's Decision.

Petitioner Cordis Corporation ("Cordis") and Respondent Medtronic, Inc. ("Medtronic") are parties to a License Agreement ("the License Agreement") pursuant to which Cordis is licensed to make, use, lease, and sell certain atrial and ventricular tined leads covered by two Medtronic patents (the "patents in suit"). Tined leads are surgically used in conjunction with implantable cardiac pacemaker pulse generators to conduct electrical signals between the pulse generator and the heart.

In late 1981 or early 1982, Cordis approached Medtronic seeking a license under the patents in suit. The License Agreement between the parties was entered into in late January or early February, 1982. (See App. A

at 43)[2] Prior to that time, Medtronic had been engaged in litigation with three of its domestic competitors, Intermedics, Inc., Pacesetter Systems, Inc., and Daig, Inc., over their infringement, and the challenged validity, of one of the two Medtronic patents that Cordis desired to license from Medtronic.[3] (See Rooney Aff., ¶¶ 3 and 4; App. A at 63-64) Cordis was aware of these controversies before it entered into the License Agreement. Recognizing that its alternatives

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2. References to "App. A" refer to the Appendix of Medtronic filed with the Court of Appeals for the Federal Circuit. References to "App." refer to the Appendix to Cordis' Petition for Writ of Certiorari.

3. Medtronic was also litigating its corresponding patents in
(Footnote Continued)

were to license the patents in suit or to risk patent litigation with Medtronic, Cordis chose the former alternative and the contractual benefits attendant to licensee status.

Cordis operated under the License Agreement for more than two years. In October 1984, Cordis' patent counsel threatened Medtronic "with a lawsuit . . . unless and until Medtronic would agree to escrowing royalty payments pending a decision" in Medtronic's patent litigation with its competitors, Pacesetter Systems, Inc. and Daig, Inc., then pending in the District of Minnesota. (See Rooney Aff. ¶ 10; App. A at 66)

When Medtronic refused Cordis' demand, Cordis commenced this action on October 19, 1984.

(Footnote Continued)
France and Germany. (See Rooney Aff. ¶ 5; App. A at 65)

By its Complaint, Cordis seeks a declaratory judgment that the patents in suit and the License Agreement itself are invalid. Cordis contemporaneously moved for an order establishing an escrow account for the deposit of royalty payments it owed Medtronic pursuant to the License Agreement, and for a preliminary injunction enjoining Medtronic from terminating the License Agreement during the pendency of the action.

The District Court (Hon. C. Clyde Atkins), by a three-page Order dated January 10, 1985, granted Cordis the relief it sought. (606 F. Supp. 132)

2. The Federal Circuit's Decision.

On December 17, 1985, the Court of Appeals for the Federal Circuit vacated the District Court's Order and remanded for further consideration. In so ruling, the Federal Circuit

determined that the District Court had misapplied Lear as mandating the creation of the escrow account sought by Cordis and the entry of the preliminary injunction enjoining Medtronic from terminating the License Agreement. Specifically, the Federal Circuit could:

> find no authority in Lear for establishing an escrow account for royalties due pendente lite or preliminarily enjoining a licensor from cancelling the license agreement and, thus, from counterclaiming for patent infringement when this material breach of the license occurs. (App. at 5a)

Focusing on language in Lear discussing the public interest underlying federal patent policy, the Federal Circuit concluded:

> This public policy statement does permit a licensee to cease payments due under a contract while challenging the validity of a patent. It does not permit the licensees to avoid facing the consequences that such an action would bring. The holding of Lear

> only prevents the affirmative enforcement by the licensor of the royalty payment provisions of the license agreement while the patent's validity is being challenged by the licensee. (App. at 6a) (emphasis in original)

The Federal Circuit went on to conclude that, in addition to misapplying Lear, the District Court made errors of law in applying the traditional standard for determining the propriety of granting a preliminary injunction. Specifically, it held that the District Court had erred in finding that Cordis had established the element of irreparable harm and in evaluating the likelihood of success factor.

REASONS FOR DENYING WRIT

I

Nothing in the Federal Circuit's Decision is Inconsistent with Lear, Inc. v. Adkins

Despite Cordis' attempt to wrap itself in the cloak of Lear, Inc. v. Adkins, 395 U.S. 653 (1969), the holding of Lear does not dispose of the issues here presented. Nor does the Lear dicta upon which Cordis relies, when considered in the context of the particular facts confronting this Court in Lear, support Cordis' position. The equities which buttressed the licensee's position in Lear are simply not present in this case. Moreover, the public interest considerations underlying federal patent law, which this Court determined compelled the result in Lear, compel a different result here.

A. Lear Does Not Compel the Relief Cordis Seeks

Neither the holding of Lear, nor its underlying rationale, compels the result Cordis seeks. As stated by Justice Harlan, and as underscored by Cordis at page 6 of its Petition, the "decisive question" in Lear was:

> whether overriding federal policies would be significantly frustrated if licensees could be required to continue to pay royalties during the time they are challenging validity in the courts. (Id. at 673) (emphasis supplied)

In contrast to Lear, Medtronic does not seek to require Cordis to do anything. Consistent with Lear, under the Federal Circuit's decision Cordis is free to determine for itself whether to continue to pay royalties to Medtronic, or to cease royalty payments during the pendency of this litigation brought by Cordis. Medtronic maintains only that, if

Cordis chooses not to honor its license obligations to Medtronic, it then has no right to the continued benefits under the License Agreement. In such event, Medtronic may terminate the License Agreement and counterclaim against Cordis for infringement of the patents in suit, as the Federal Circuit concluded.

While there is language in Lear which, in the abstract, might be generally viewed as preferring the rights of the licensee (Lear, Inc.) to those of the licensor (Adkins), that language must be considered in the context of the particular facts there before this Court.[4]

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4. Cf. Cohens v. Virginia, 19 U.S. (6 Wheat.) 264, 399 (1821) (Marshall, C.J.) ("It is a maxim not to be disregarded, that general expressions, in every

(Footnote Continued)

In Lear, the license agreement was entered into before any patent had issued. It called for the payment of royalties based upon the use of the claimed invention both before and during the life of any patent which might issue. Subsequent to negotiation of the license agreement, but prior to the issuance of the patent, Lear -- as licensee -- notified Adkins -- as licensor -- that Lear had found a patent which it believed fully anticipated Adkins' claimed invention. Lear then terminated all payments under the agreement and expressly repudiated the license agreement more than two years prior to the issuance of Adkins' patent. Thus, when Adkins brought suit, no

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(Footnote Continued)
opinion, are to be taken in connection with the case in which those expressions are used.")

contractual relationship existed between the parties. 395 U.S. at 659-660.

This Court initiated its analysis of the facts of Lear with an assessment of "the spirit of contract law, which seeks to balance the claims of promisor and promisee in accord with the requirements of good faith." Id. at 670. Only after satisfying itself that the equities were balanced did this Court proceed to consider the policy underlying the federal patent laws and the public interest.

In contrast to Lear, Cordis entered into the License Agreement knowing full well that the Medtronic patents it sought to license were the subject of ongoing litigation between Medtronic and third parties, and that their validity was at issue in that litigation. For more than two years, Cordis enjoyed the benefits and protection

of the License Agreement, the two licensed patents and the corresponding foreign patents. When it became expedient to do so, Cordis decided to join the other infringers of the patents in suit by belatedly challenging their validity in this declaratory judgment action.

Unlike Lear, however, Cordis did not repudiate its contractual relationship with its licensor, Medtronic. Rather, it brought suit and immediately sought to secure for itself the right to uninterrupted enjoyment of the fruits of the License Agreement, free of any obligation to make royalty payments to Medtronic, pending final resolution of this action. The inequity of Cordis' attempt to rewrite by judicial fiat its contract with Medtronic, to its sole benefit and Medtronic's detriment, stands in stark contrast to the position of the licensee in Lear.

B. The Public Interest Considerations Underlying Lear Support the Conclusion Reached by the Federal Circuit

The heart of Lear is this Court's effort to strike a middle ground between the sanctity of a bargained-for agreement, rooted in contract law, and the public interest in free access to ideas underlying federal patent law. See 395 U.S. at 668. In contrast to the emphasis in Lear on achieving a balance between these competing concerns, the approach advocated by Cordis, once a licensee challenges the validity of a licensed patent, would require the courts to disregard entirely the parties' bargain. Cordis prefers a result that guarantees to it, as licensee, all of its benefits under the License Agreement during the pendency of its patent validity challenge, while holding the licensor

(Medtronic) in contractual limbo, with none of its bargained-for benefits, and all of its bargained-for burdens, for the duration of this litigation.

In Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 480-81 (1974), this Court stated:

> The stated objective of the Constitution in granting the power to Congress to legislate in the area of intellectual property is to "promote the Progress of Science and useful Arts." The patent laws promote this progress by offering a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research, and development. The productive effort thereby fostered will have a positive effect on society through the introduction of new products and processes of manufacture into the economy, and the emanations by way of increased employment and better lives for our citizens.

* * *

> When a patent is granted and the information contained in it is circulated to the general public and those especially skilled in the trade, such additions to the general store of knowledge are of such importance to the public weal that the Federal Government is willing to pay the high price of 17 years of exclusive use for its disclosure, which disclosure, it is assumed, will stimulate ideas and the eventual development of further significant advances on the art.

The exclusive rights conferred by a patent grant, then, are designed not only to encourage invention, but more importantly to encourage the disclosure of the invention to the public.

To foster the public interest in disclosure of inventions by encouraging resort to the patent system in the first instance, as well as the subsequent licensing of issued patents, it is imperative that there be a perceptibly fair balance between the rights of the

licensor and those of the licensee. To prefer, by such a great measure, the interests of the licensee to those of the licensor, as the District Court did and as Cordis urges, seriously risks undermining the incentives an inventor will have to share his invention through conventional licensing arrangements. As one commentator noted in this regard:

> Any rule of law that discourages licensing, one of the main benefits of owning a patent, conflicts with the policy that encourages inventors to use the patent system, and any interpretation of Lear that pushes inventors away from the patent system cannot be within the true spirit of either Lear or federal patent policy.

J. McCarthy, "Unmuzzling" The Patent Licensee: Chaos in the Wake of Lear v. Adkins (Part I), 59 J. Patent Office Society 475, 496 (1977).

The "licensee choice" rule reflected in the Federal Circuit's

decision, here challenged by Cordis, is a fair solution to the question of how traditional contract law should be shaped to give licensees adequate incentive to challenge patent validity consistent with Lear's emphasis on balancing the equities among licensor, licensee, and the public interest.[5] As the Federal Circuit

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5. Legislation sponsored by the Administration and now pending in Congress recognizes the need for the same kind of balance. Title VII of the Intellectual Property Rights Improvement Act of 1986 would add a new Section 296 to Title 35, United States Code, to address the rights of licensees to challenge the validity of patents they have licensed and the corresponding rights of patent holders in such circumstances. Proposed new Section 296(a) codifies the holding of Lear by providing that a licensee shall not be estopped from asserting the invalidity of a patent to which it licensed. Proposed new Section

(Footnote Continued)

recognized, Lear permits a licensee to challenge patent

(Footnote Continued)
296(b) addresses the rights of the parties with respect to termination of the license and payment of royalties if the licensee challenges the validity of the licensed patent.

As described in the Section-by-Section Analysis of the proposed Act released by the Office of the U.S. Trade Representative on April 7, 1986:

> New Section 296(b) would give the parties broad discretion to define these rights during the license negotiation process. It makes clear that the parties may provide for termination by licensor and/or licensee in the event of such a challenge, and, if the licensee has a right to terminate, for the licensee's obligations to continue pending adjudication of validity. In this way, patent licensors can bargain for provisions they feel necessary to assure the realization of their rights
>
> (Footnote Continued)

validity and not pay royalties during the challenge period. If

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(Footnote Continued)

> in an invention, while licensees can bargain for provisions they feel necessary to protect their interests if they choose to challenge validity. (emphasis supplied)

See Administration's Statement on Protection of U.S. Intellectual Property Rights Abroad, Draft Bill Entitled "Intellectual Property Rights Improvement Act of 1986" and Section-by-Section Analysis of Draft Bill, Released by Office of the U.S. Trade Representative, April 7, 1986, 31 Patent, Trademark & Copyright Journal (BNA) 506, 516 (April 10, 1986).

The License Agreement negotiated by Cordis with Medtronic provides for termination in the event "either party shall materially breach any of the terms, conditions and agreements contained in this Agreement," (License Agreement, § 10.02(a), App. A at 37), which would obviously include the failure by Cordis to pay royalties as due

(Footnote Continued)

the licensee elects this option, however, it should not be permitted to hide behind the protection of a license agreement as a shield against a claim of patent infringement. Nor, under the Federal Circuit's decision, is a licensor, in this situation, precluded from terminating the license agreement because of the licensee's breach for non-payment of royalties. If the licensee wishes to "hedge its bet" on patent invalidity by protecting itself against a claim of infringement, it can do so by continuing to pay the royalties due its licensor under its license agreement.

The balance struck between the rights of licensees and licensors by the Federal Circuit

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(Footnote Continued)
during a patent validity challenge.

accommodates the public interest in "unmuzzling" licensees to challenge invalid patents, see Lear, 395 U.S. at 670, without eliminating the equally important public interest in providing incentives for inventor/licensors to obtain and license patents. In its balancing of both public interest considerations, the Federal Circuit's decision is wholly consistent with Lear, thus raising no issue worthy of this Court's discretionary review.

Cordis' protestations notwithstanding, the decision of the Federal Circuit in this case does not present Cordis with:

> a "Hobson's choice"[6] which frustrates the overriding

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6. Although Cordis insists that it is confronted with a "Hobson's choice," that is clearly not the case. A "Hobson's choice," according to Webster's Third New

(Footnote Continued)

> federal policies of Lear just as surely as actually ordering that royalties be paid during the litigation. (Petition at 7); (footnote added)

The consequence to Cordis of the Federal Circuit's decision is that it must continue to honor the terms of the License Agreement if it wishes to enjoy the benefits of that contract during the pendency of this action. Cordis may thereby continue to enjoy the use

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(Footnote Continued) International Dictionary, properly refers to an apparent freedom of choice where none exists. The term derives from the practice of an English liveryman, named Hobson, who required every customer to rent the horse which was stabled nearest to the stable door. Cordis concedes that the Federal Circuit's decision leaves it with several options, albeit ones which Cordis finds unpalatable. By definition, Cordis is not confronted with a Hobson's choice.

of the patents in suit, which are presumed to be valid and which twice have been adjudicated to be valid, while it pursues its validity challenge.[7] In addition,

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7. In Medtronic, Inc. v. Intermedics, Inc., Civil No. G-80-295 (S.D. Tex., Galveston Division), the jury, in August 1983, returned a verdict finding Medtronic's Citron/Dickhudt patent, one of the two patents in suit, to be valid and infringed. In response to the motion of Intermedics for a new trial based on the discovery of alleged "new evidence," the District Court (Hon. Hugh Gibson) deferred entry of judgment on the jury verdict pending a decision by the United States District Court for the District of Minnesota in Medtronic, Inc. v. Daig Corporation, Civil No. 4-79-256 (D. Minn.), a case involving the same Medtronic patent in which the alleged "new evidence" had been presented. In June 1985, the Minnesota District Court (Hon. Earl R. Larson) ruled that the Medtronic patent was valid and

(Footnote Continued)

under the terms of the License Agreement, Medtronic is obligated to license or prosecute infringers of the patents in suit whose net sales exceeded specified limits, thereby providing Cordis with protection against competition from unlicensed competitors. (See License Agreement § 9.01; App. A at 35-36) In Lear, this Court observed that "[e]ven in the case of nonexclusive licenses, . . . competition is limited to the extent that the royalty charged by

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(Footnote Continued)
infringed. Thereafter, by Order dated October 4, 1985, the Texas District Court denied Intermedics' post trial motions and entered judgment for Medtronic. The decisions in both the Minnesota and Texas actions are currently on appeal to the Federal Circuit. See Daig Corporation v. Medtronic, Inc., Appeal No. 85-2645, and Medtronic, Inc. v. Intermedics, Inc., Appeal No. 86-647 (United States Court of Appeals for the Federal Circuit).

the patentee serves as a barrier to entry." 395 U.S. at 669, n.16. Finally, in addition to the use of the patents in suit, Cordis continues to enjoy the right to use the corresponding foreign patents. (See License Agreement § 1.05; App. A at 3)

In contrast to the option afforded Cordis to continue receiving the benefits of the License Agreement, while at the same time contesting the validity of the licensed patents, the District Court's Order in this case, and the position urged by Cordis, would deprive Medtronic of any similar option to enjoy the benefit of its bargain during the pendency of this litigation. By permitting Cordis to escrow royalties, Medtronic would be effectively deprived of any benefit of the License Agreement

throughout this litigation.[8] That Medtronic ultimately might be entitled to the escrowed royalties does not alleviate the harm to Medtronic from being deprived of receiving Cordis' royalty payments during the time the License Agreement remains in effect, while Medtronic remains obligated to defend the patents in suit against other infringers at Medtronic's expense, and also while Medtronic is confronted with the expenses of defending against Cordis' patent invalidity claims.

In sum, in its lopsided preference for the rights of the licensee to those of the licensor,

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8. As one court has correctly noted, in the eyes of the law, payment of royalties to an escrow agent is tantamount to non-payment. PPG Industries, Inc. v. Westwood Chemical, Inc., 530 F.2d 700, 705 (6th Cir.), cert. denied, 429 U.S. 824 (1976).

the position urged by Cordis as an extension of Lear is clearly contrary to the delicate balancing of competing public interests which lies at the heart of Lear, and, accordingly, is not deserving of discretionary review by this Court.

II

The Federal Circuit's Decision is Based Upon the Application of Well-Settled Principles Governing the Issuance of Injunctive Relief to Specific Facts and Thus Does not Present "an Important Question of Federal Law Which has not Been, but Should be, Settled by This Court" (Sup. Ct. R. 17.1(c))

The Federal Circuit's decision applied traditional and well-settled principles for appellate review of a grant of injunctive relief to the facts presented to it. Applying the traditional four-pronged test for granting a preliminary injunction, the Federal Circuit concluded that the District Court committed errors of law in holding that Cordis had demonstrated the likelihood of irreparable harm necessary for issuance of a preliminary injunction and in evaluating the likelihood of success factor. (App. at 6a-8a)

Nothing in the Federal Circuit's review of the District Court's application of the preliminary injunction standard constitutes the deciding of "an important question of federal law which has not been, but should be, settled by this Court" within the meaning of Supreme Court Rule 17.1(c), so as to warrant the exercise by this Court of discretionary review.

Cordis attempts to create an issue of unsettled federal law by inviting this Court to decide whether royalties paid by a licensee during a patent validity challenge are ultimately recoverable by the licensee, if the patent is ultimately held invalid. See Petition at 10-13. The Federal Circuit properly declined to decide that issue in the context of the appeal before it. (App. at 8a) Cordis, nonetheless, persists in arguing that the question of whether a licensee may

escrow royalties during the pendency of its patent validity challenge, and the question of ultimate entitlement to royalties paid during a patent validity challenge, are inextricably entertwined. Thus, at page 9 of its Petition, Cordis argues that:

> Such an escrow arrangement clearly eliminates the "chilling effect" imposed on the challenger-licensee because of the uncertainty about repayment of royalties.

Although neither this Court, nor the Federal Circuit, has addressed the "ultimate entitlement" issue, the resolution of that issue cannot rationally depend on whether royalties had been paid to a patentee-licensor during the pendency of the litigation or into an escrow fund. The situs of royalty payments pendente lite is not determinative of the question of ultimate entitlement. See, e.g., USM Corp. v. Standard

Pressed Steel, 524 F.2d 1097, 1099 (7th Cir. 1975), and cases cited therein. Thus, the Federal Circuit's resolution of the escrow fund issue did not decide the "ultimate entitlement" issue. That issue simply is not properly before this Court.

III

There is no Conflict in the Circuits Sufficient to Warrant the Exercise by This Court of its Discretionary Review

Cordis contends (Petition, 10-13) that there is a conflict among the circuits sufficient to warrant this Court's exercise of its discretionary review. No such conflict exists. By creating the United States Court of Appeals for the Federal Circuit, and vesting in it exclusive appellate jurisdiction in patent cases (28 U.S.C. § 1295), Congress eliminated any possibility of conflicting views among the federal appellate courts on patent matters. Prior decisional law of the other federal circuit courts is superseded by the Federal Circuit's decision below. To the extent the District Court perceived a conflict among the other federal circuits at the time it rendered its initial

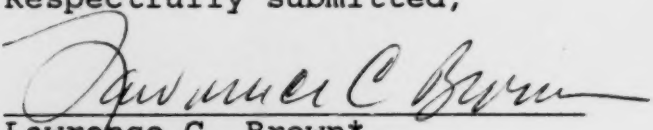
order, that "conflict" has been resolved now that the Federal Circuit has spoken.

CONCLUSION

This Court should deny the requested relief.

Dated: April 29, 1986

Respectfully submitted,



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No. 85-1443

IN THE

Supreme Court of the United States

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Petitioner,

vs.

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Respondent.

PETITIONER'S REPLY IN SUPPORT OF PETITION FOR CERTIORARI

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I. MEDTRONIC'S OPPOSITION IS A DIRECT ATTACK ON THE *LEAR* MANDATE

MEDTRONIC does *not* dispute that: (1) *Lear* v. *Adkins* is a watershed decision in patent law; (2) the Supreme Court has provided no guidance concerning the appropriate interpretation and application of *Lear*; and (3) *Lear* has been subject to conflicting interpretations among the Federal Circuit Courts of Appeal on the very issues presented by this Petition.

Instead, MEDTRONIC essentially repeats the classic arguments for subjugation of Federal patent policy to private contract, which were expressly and repeatedly rejected by the Supreme Court in *Lear*. Indeed, MEDTRONIC's Opposition (and the Federal Circuit's decision) is a direct attack on the express public policy mandate of *Lear*; i.e., when in conflict, private contract doctrine must give way to Federal

patent policy—and actually demonstrates why this Court should grant Certiorari to review the merits of the Federal Circuit's decision.

II. THE FEDERAL CIRCUIT'S (and MEDTRONIC'S) INTERPRETATION OF *LEAR* IS AT ODDS WITH THE SUPREME COURT'S STATEMENTS IN *LEAR*

Almost all of MEDTRONIC's Opposition (pp. 9-29) is directed to a rehash of the classic arguments for subjugation of patent policy to private agreement, which were directly repudiated in *Lear*. In *Lear*, this Supreme Court repeatedly, and without qualification, stated that when in conflict, Federal patent policy must be preeminent over private contract doctrine:

> We think it plain that the technical requirements of contract doctrine must give way before the demand of the public interest in the typical situation involving the negotiation of a license after a patent has issued,[1] 395 U.S. 670-71.

The Supreme Court's earlier analysis makes it clear that this statement was intended as a direct repudiation of the argument that "under ordinary contract principles the mere fact that some benefit is received is enough to require the enforcement of the contract, regardless of the validity of the patent", 395 U.S. at 669. MEDTRONIC makes the very same, warmed-over (and still ineffectual) argument in its Opposition.

On a *second* occasion, the Supreme Court in *Lear* stated:

> The equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain, 395 U.S. at 670.

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[1]Similarly, in this case the license was entered *after* the patents had issued.

On a *third* occasion, in holding that a licensee may not be compelled to pay royalties while challenging validity, this Court in *Lear* stated that "the parties' contract . . . is no more controlling . . . than is the State's doctrine of estoppel [which it had rejected] which is rooted in contract principles," 395 U.S. at 673. MEDTRONIC's Opposition and the Federal Circuit's decision completely ignore this overriding principle of public policy set forth in *Lear*.

Instead of addressing this fundamental conflict, MEDTRONIC attempts to contrast the equities of the present situation with those in *Lear* (Med. Opp. pp. 12-15). However, even this attempt emphasizes that the very language of *Lear* must be ignored to rationalize the Federal Court's decision. In the present case, CORDIS entered the License Agreement *after* the patents in suit had issued and did *not* receive know-how or technical assistance from MEDTRONIC, as the licensee did in *Lear*. The Supreme Court specifically commented in *Lear*:

> The case before us, however, *presents a far more complicated estoppel problem than the one which arises in the most common licensing context* [where the license is entered after the patent issues]. The problem arises out of the fact that Lear obtained its license . . . more than four years before Adkins received his . . . patent. Indeed, from the very outset of the relationship, *Lear obtained special access to Adkins' ideas in return for its promise to pay satisfactory compensation.*
>
> Thus, during the lengthy period in which Adkins was attempting to obtain a patent, Lear gained an important benefit not generally obtained by the typical licensee. (Emphasis added) 395 U.S. at 671.

Despite the more compelling equities for the licen*sor* in *Lear*, the Court held that the licen*see* could not be compelled to pay royalties during the pendency of the lawsuit. Thus, MEDTRONIC's effort to contrast the balance of equities in the present situation with those of *Lear* is actually contrary

to the Supreme Court's own analysis of the equities—which clearly places this case in the class of "typical" licenses, where the public policy of *Lear* even more vigorously applies.

Finally, MEDTRONIC argues that the District Court's Order is inconsistent with the public interest of encouraging inventors to make, patent, and license their inventions (Med. Opp. pp. 16-18). This argument, however, is misdirected. The Federal policy of encouraging the patenting of inventions is perhaps better stated as encouraging the patenting of "patentable" inventions. There is certainly no Federal patent policy of fostering the patenting and/or licensing of "unpatentable" inventions. In accordance with *Lear*, the patenting and/or licensing of "unpatentable" inventions *should* be challenged.

The upshot of these arguments is that MEDTRONIC's Opposition and the Federal Circuit's decision fly directly in the face of the clear public policy directive of *Lear*; i.e., when in conflict, Federal patent policy must be preeminent over private contract doctrine. Such conflict plainly exists in this case and requires that MEDTRONIC's contract-based arguments give way to the Federal patent policy of free and open competition in unpatentable ideas.

III. THE DECISION OF THE FEDERAL CIRCUIT PRESENTS PATENT LICENSEES WITH A "HOBSON'S CHOICE" ANTAGONISTIC TO FEDERAL PATENT POLICY

MEDTRONIC's (and Webster's) definition of a "Hobson's choice" is perfectly appropriate for the situation created by the Federal Circuit's decision—the appearance of freedom of choice when none realistically exists.

As set forth in CORDIS' Petition (pp. 6-8), the practical result of the Federal Circuit's decision is that when faced with the real-world choices presented by that decision, patent licensees will not undertake a challenge to the validity of the licensed patents. As a result, even licensed patents believed to be invalid will not be litigated. The licensor will continue

to profit to the detriment of the licensee and, most importantly, to the detriment of the public at large, and the very purpose and policy of *Lear* will be frustrated.

IV. THE FEDERAL CIRCUIT'S OPINION DOES *NOT* RESOLVE THE CONFLICT AMONG THE CIRCUIT COURTS OF APPEAL

MEDTRONIC finally contends that because of the Federal Circuit's exclusive jurisdiction of patent appeals, there will be no further conflicts concerning the interpretation and application of *Lear* (Med. Opp. pp. 34-35). This argument is simply wrong.

The Federal Circuit Court of Appeals hears patent cases *only* if the original jurisdiction of the case was based in whole or in part on 28 U.S.C. 1338,[2] i.e., when the action involves a substantial charge of patent infringement, 28 U.S.C. 1295(a)(1). Not all patent licensing issues, however, include a charge of patent infringement. Those cases are routinely heard in the State Courts or, if diversity is present, in the Federal Courts (with any appeal to the regional Circuit Courts of Appeal). Indeed, *Lear* itself was *not* a case which would have been appealed to the Federal Circuit Court of Appeals. *Lear* was purely a contract action arising out of the California State Courts.

For these plain and indisputable reasons, the decision by the Federal Circuit Court of Appeals does *not* resolve the conflict among the various Courts of Appeal. Unless resolved by this Court, that conflict will continue unabated—to the detriment of the U.S. patent system and the public.

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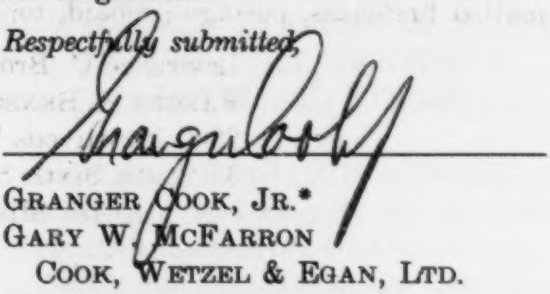
[2]The Federal Circuit Court of Appeals may also hear patent cases on appeal from the Patent and Trademark Office or in review of final determinations of the International Trade Commission, but those are not pertinent to this case.

CONCLUSION

For the reasons set forth in the Petition for Certiorari and in this Reply, it is respectfully requested that the Petition for a Writ of Certiorari be granted.

Respectfully submitted,



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CERTIFICATE OF SERVICE

It is hereby certified that at least three copies of the foregoing PETITIONER'S REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI have been mailed first-class, postage prepaid, to:

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this 7th day of May, 1986.

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